

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

In the Matter of)
)
PUBLIC UTILITIES COMMISSION)
)
Instituting a Proceeding to Investigate)
the Implementation Of Feed-in Tariffs)
_____)

Docket No. 2008-0273

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HAIKU DESIGN AND ANALYSIS
RESPONSE TO THRESHOLD LEGAL QUESTIONS IN APPENDIX C OF THE NATIONAL
REGULATORY RESEARCH INSTITUTE SCOPING PAPER
AND
CERTIFICATE OF SERVICE

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HAIKU DESIGN AND ANALYSIS

**RESPONSE TO THRESHOLD LEGAL QUESTIONS IN APPENDIX C OF THE
NATIONAL REGULATORY RESEARCH INSTITUTE SCOPING PAPER**

Carl Freedman, dba Haiku Design and Analysis (HDA) respectfully offers the following responses to the threshold legal questions in Appendix C of the National Regulatory Research Institute (NRRI) scoping paper titled *Feed-in Tariffs: Best Design Focusing Hawaii's Investigation* (Scoping Paper).¹ HDA does not attempt to provide a thorough legal analysis of each of the questions. HDA also does not provide its responses as arguments or strongly held positions. The responses below are offered as observations and assertions regarding each question intended as suggestions for the Commission to consider in its deliberations on these threshold issues.

¹ The Commission's letter dated December 11, 2008 in this docket directs the parties to respond to threshold questions in Appendix A of the Scoping Paper. HDA presumes the intended questions are the threshold questions found in Appendix C of the Scoping Paper.

1. **If the price associated with a feed in tariff exceeds the utility's avoided cost, then by definition the utility's customers will incur higher costs than they would in the absence of the feed in tariff. Please comment on the legal implications of this result. For example:**
 - a) **Is this result permissible under current Hawaii statutes?**
 - b) **Does HRS § 269 27.2 create a ceiling on the feed in tariff price?**
 - c) **If so, how do the signatories to the Energy Agreement (or other parties to this proceeding) propose to demonstrate that each feed in tariff price does not violate the statute?**

Response:

This set of questions pertains to the legality of project-based feed in tariffs above avoided costs according to Hawaii statutes.

- **CLARIFICATION OF A FINE POINT:** It is true that if a feed in tariff exceeds the utility's avoided cost, customers will, on the average, incur higher prices in most circumstances. From the standpoint of both federal and state laws, however, increased costs to customers is not the pertinent legal issue or threshold. Federal and state laws (and the associated body of case law) that address any prohibitions on exceeding avoided costs pertain directly to prices set by state commissions for wholesale transaction and purchase of power by utilities.

- **HRS 269-27.2 DOES CREATE A CEILING ON FEED IN TARIFF PRICE:** HRS-269-27.2 includes several provisions regarding purchase of electricity generated from non fossil fuel sources. The language includes the following provision:

In the exercise of its authority to determine the just and reasonable rate for the nonfossil fuel generated electricity supplied to the public utility by the producer, the commission shall establish that the rate for purchase of electricity by a public utility shall not be more than one hundred per cent of the cost avoided by the utility when the utility purchases the electrical energy rather than producing the electrical energy. [HRS 269-27.2 (c)]

This provision is explicit and appears to be applicable broadly to all wholesale prices set by the Commission for electricity generated from nonfossil fuel sources.

- **HRS 269-27.2 COULD POSSIBLY BE AMENDED:** The 2009 session of the Hawaii Legislature is about to begin. There are several proposed bills in draft form that propose amendments to HRS Chapter 269. It is possible that the specific provision in 269-27.2 that prohibits wholesale prices for non fossil fuel generated electricity above avoided costs could be amended.

- **QUANTIFICATION OF AVOIDED COSTS COULD INCLUDE SEVERAL FACTORS NOT CURRENTLY INCORPORATED:** Calculations of avoided costs are based on projections of expected future costs, some of which are substantially uncertain. Additional expected future costs that could be included in the quantification of avoided costs include costs specifically associated with fossil fuel generation including (1) the expected costs of carbon emissions mitigation, trading or taxes or (2) costs of hedging or other means to reduce price volatility.² Avoided costs could, where applicable, also include a component of avoided capacity costs for as-available generation to the extent that as-available generation measurably contributes to system reliability and reduces the need for new firm generation capacity.
 - **QUANTIFICATION OF AVOIDED COSTS HAS RECENTLY BECOME MORE DIFFICULT:** The volatility of the oil prices that underlay the bulk of the variable cost component in Hawaii's utility avoided costs has increased dramatically in the past year. In the year 2008 crude oil prices went from \$90 to \$140 and then to less than \$40 per barrel. This level of volatility is unprecedented and makes determination of avoided costs for use as a regulatory standard substantially more difficult than it has been in previous matters before the Commission. At this time, for example, there is no existing recent or credible utility fuel price forecast for the HECO companies that could be used to determine reasonable avoided cost projections. This is more a practical matter than a legal issue but could be considered in conjunction with consideration of legal threshold issues.
- 2. As with any administrative agency decision, a Commission decision approving a feed in tariff must be supported with substantial evidence.**
- a) **Focusing on the price term, what evidence is legally necessary? Consider these options, among others:**
 - i) **evidence of actual costs to develop similar projects in Hawaii**
 - ii) **generic (i.e., non Hawaii) evidence of costs associated with each particular technology**
 - iii) **evidence that the tariff price results in costs equal to or below the utility's avoided cost**

² Several FERC and court decisions have determined that adders to avoided costs to account for "externality" impacts of fossil fuel generation are not allowed in determining avoided costs pertaining to wholesale purchase of power from qualifying facilities required by PURPA. The costs identified here, however, are not external costs. These are both expected real "forecasted" dollar costs that would be incurred if the utility generates or purchases power from fossil fueled sources. Note that costs for hedging or other measures to reduce fossil fuel price volatility would only be real expected dollar costs if the Commission would require the utility to hedge or otherwise mitigate its fossil fuel cost volatility if electricity is not purchased from non fossil fuel sources.

- b) **By what process do the signatories (and other parties to this proceeding) propose to gather this evidence and present it the Commission, under the procedural schedule proposed by the signatories?**

Response:

Regarding what evidence is necessary HDA suggests that:

- (1) All of the three types of evidence could be considered.
- (2) Neither of the first two specific types of evidence is strictly necessary if reasonable prices can be set based on other types of evidence such as testimony regarding the prospective costs of developing new projects in Hawaii.
- (3) The third type of evidence would be necessary if it is determined that tariff prices must be equal to or below avoided costs. If prices are allowed above avoided cost some evidence (and policy) is needed to establish that the costs are reasonable.³

The standard for necessary evidence regarding setting prices in this proceeding is not different than the standards applied in other proceedings that affect rates including, for example, general rate cases, the recent energy efficiency docket or proceedings to the determine the reasonableness of power purchase agreements. As is the case in these other matters, the Commission should base its decision on a preponderance of evidence in the record of the proceeding. It is true that sufficient probative and substantial evidence is necessary but not to any greater degree than in other Commission proceedings that affect rates.

Regarding the process to provide the necessary evidence HDA observes that this will be challenging given the aggressive schedule in this docket proposed by the Commission and the parties. The Scoping Paper suggests that at least some of this evidence will be gathered in responses to the questions in Appendix A of the Scoping Paper

3. **Assume the Commission does create feed in tariffs, which entitle the seller to sell to the utility at the tariff price.**

- a) **If the tariff price exceeds the utility's avoided cost, is there a violation of PURPA, provided the seller is relying on a state law right to sell rather than a PURPA right to sell?**

Response:

The fact that there is a state requirement for a utility to purchase power is not likely to affect whether there is a violation of PURPA.⁴ In several previous

³ Avoided cost has historically served as a principal standard to determine cost effectiveness and "reasonableness" of costs of both supply and demand side resources. The standard practice "cost tests" used in evaluating energy efficiency and load management resources as well as the differential revenue requirements analyses used in evaluating supply resources are all fundamentally based on an avoided cost standard and approach.

Federal Energy Regulatory Commission (FERC) decisions and associated court rulings it has been determined that states are preempted from setting rates inconsistent with the PURPA regardless of various other state requirements. FERC affirms the authority of state regulatory agencies to make resource planning decisions, diversify generation portfolios to meet environmental goals, account for environmental costs in setting avoided costs (in all source bidding procedures), and to "require a utility to construct generation capacity of a preferred technology or to purchase power from the supplier of a particular type of resource."⁵ In pursuing policy choices regarding particular generation technologies, however, state regulatory agencies must consider PURPA and FERC regulations and cannot require a utility to purchase power at a rate in excess of the least avoided cost.⁶ In light of these previous determinations it is difficult to see how the existence of a state tariff requirement (as suggested in the question) would nullify preemption by PURPA.

- b) If the tariff price exceeds the utility's avoided cost (as calculated prior to the existence of the tariff), could a seller assert a PURPA right to a sale at the tariff price, on the grounds that the utility now has a new "avoided cost" equal to cost it would have incurred under the state mandated feed in tariff?**

Response:

No. FERC interprets avoided costs to be the least avoided cost of any alternative available to the utility. Avoided costs applied under PURPA cannot be determined by methods (including competitive bidding procedures) that limit alternatives considered in determining avoided costs to particular types of resources or set asides. Avoided costs must be determined by the least cost of any available sources of power (least avoided cost). Competitive bidding used to determine PURPA avoided costs must be all source bidding procedures.⁷

⁴ See response to part (d) of this question, however, which asserts that PURPA pricing restrictions may not apply to setting feed in tariffs in this docket.

⁵ Southern California Edison Company, *Order on Petitions for Enforcement Action Pursuant to Section 210(b) of PURPA*, Docket No. EL95-16-000, 70 F.E.R.C. @ 61,215 (February 23, 1995) at page 23

⁶ Ibid. And see response to part (b) of the question.

⁷ These assertions are documented in several documents originally cited in the Hawaii Commission's "Second Concept Paper" in the Act 95 Workshops: Proposals for Implementing Renewable Portfolio Standards in Hawaii, July 26, 2005 prepared by Economists Incorporated at page 77: See Connecticut Light and Power Company, *Order Granting Petition for Declaratory Order*, Docket No. EL93-55-000, 70 F.E.R.C para 61,012 (January 11, 1995); Southern California Edison Company, *Order on Petitions for Enforcement Action Pursuant to Section 210(b) of PURPA*, Docket No. EL95-16-000, 70 F.E.R.C. @ 61,215 (February 23, 1995); San Diego Gas & Electric Company, *Order on Petitions for Enforcement Action Pursuant to Section 210(h) of PURPA*, Docket No. EL95-19-000, 70 F.E.R.C para 61,215 (February 23, 1995).

- c) **If the price associated with a feed in tariff is less than the utility's avoided cost, what benefit does the tariff offer the developer that is not already available under PURPA?**

Response:

PURPA provides a ceiling but no guarantee of full avoided costs. Tariffs set at avoided costs, for example, would be higher than costs negotiated in recent wind power PPA's.

There are some benefits to potential developers other than the magnitude of the price in a feed in tariff. The surety of the price, the fact that there are pre-existing clear terms and any other ancillary provisions in the tariff may provide certainties that are valuable to developers.

- d) **Please offer any other comments concerning the legal and practical relationship between the feed in tariff and existing PURPA rights and obligations.**

Response:

PURPA PRICE PROVISIONS MAY NOT APPLY TO SETTING FEED IN TARIFFS IN THIS DOCKET: PURPA prohibitions on prices above avoided cost may not apply to setting feed in tariffs in this docket since the utilities have essentially *requested and agreed* to establish project-based feed in tariffs that could exceed avoided costs for some renewable technologies. PURPA restrictions prohibit states from *requiring* utilities to purchase power at above avoided costs. Nothing in PURPA, however, prevents state commissions from approving power purchase contracts at rates above avoided costs where the utility and independent power producer have agreed on pricing and other terms. PURPA's mandatory pricing restrictions pertain only to circumstances where states require a utility to purchase electricity otherwise "unwillingly". In this docket the HECO utilities have specifically requested project-based tariffs rather than avoided cost based tariffs and may ultimately agree to specific prices above avoided costs. So what's the rub? PURPA does not prevent the Commission from approving tariffs above avoided costs proposed or agreed to by a utility.⁸

If indeed there is merit to the assertion above, a corollary legal question would be what type of affirmation, stipulation or other legal instrument, if any, would be necessary to memorialize the utility's current acquiescence to project based feed in tariffs that are above avoided cost in such a way that

⁸ Note that this line of reasoning does not apply to the Hawaii statute provisions in HRS 269-27.2 which apply more broadly. The Hawaii statute flatly prohibits the Commission from implementing wholesale rates above avoided cost and is not contingent upon circumstances.

would apply to and be binding on future instances where the agreed feed in tariffs would be applied.

- 4. Feed in tariffs, if approved by the Commission, would join an array of legislative and regulatory initiatives to boost production of renewables in Hawaii. Those initiatives include PURPA, the renewable portfolio standard, net metering and various distributed generation actions. Are there overlaps, redundancies, gaps among these multiple initiatives? What is the independent purpose of each of these, in relation to the others?**

Response:

HDA does not offer a comprehensive response to these questions but notes that there are redundancies overlaps and gaps in these multiple initiatives. Recent agreements and initiatives promise to add to the list of initiatives but there is no over-arching venue to evaluate or coordinate these initiatives.

One prominent initiative missing from the list is Integrated Resource Planning (or its pending replacement planning process) which could be implemented to more directly "boost" renewable energy production in Hawaii.

Conclusion:

In short, HDA asserts that project cost based feed in tariffs that are above avoided cost are legal only if:

- (1) HRS 269-27.2 is amended to remove prohibition of wholesale rates above avoided cost and
- (2) federal PURPA restrictions are rendered moot by way of the HECO companies formally acquiescing to abide by the tariffs set in this docket.

HDA supports implementation of both of these actions.

CERTIFICATE OF SERVICE

The foregoing HAIKU DESIGN AND ANALYSIS RESPONSE TO THRESHOLD
LEGAL QUESTIONS IN APPENDIX C OF THE NATIONAL REGULATORY RESEARCH
INSTITUTE SCOPING PAPER was served by electronic transmission on the date of signature
below to the following parties in this docket:

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Dated: January 8, 2009; Haiku, Hawaii

Signed: CARL FREEDMAN
Carl Freedman
dba Haiku Design and Analysis